ES 0-434

FINANCING COOPERATIVES*

All businesses, including cooperatives, exist for the economic benefit of their owners. All businesses have two major life-lines: money and people.

Like people, every cooperative is different. Their sources and uses of money are different. The purpose of this presentation is to examine alternative sources of money available to cooperatives..

These sources are generally categorized into two groups: equity capital and debt capital.

Equity capital provides the necessary element of ownership and control. It is the risk capital. It serves as a buffer to absorb operating losses and any shrinkage in asset value.

Members contribute equity to their cooperatives by (1) investing some or all of their savings or margins; (2) purchasing capital stock or other securities; and (3) investing capital retains.

The invested savings method is used most extensively. About three out of every four dollars of equity capital have been acquired by cooperatives from savings distributed as patronage refunds and reinvested by patrons.

Marketing cooperatives often use the third method-per unit capital retains. More than a third of the total equity of marketing cooperatives has been contributed by patrons through this method.

I. Sources of Equity Capital

A. Stock Cooperatives

- About 78 percent of the farmer cooperatives are organized on a stock basis

1. Common Stock

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- Used as voting stock
- Par Value - usually nonassessable
- May or may not pay interest
- Bylaws should provide for retirement or transfer
- May be divided into various classes (e.g., Class A, B and C). Each class may have different par value, interest rate and/or voting rights
- Usually insufficient to provide all the capital required

2. Preferred Stock

- Draws a fixed annual interest rate, usually the maximum legal rate is 8%
- Usually does not have a maturity date
- Usually carries no vote and may be held by members as well as by non-members
- Paid off before common stock if coop goes out of business

B. Non Stock Cooperatives

1. Membership Certificates

- Given upon payment of membership fees
- Usually does not generate very much equity capital

2. Capital Certificates

- Similar to preferred stock certificates
- Non members may own - with no voting power

Types of Equity Capital	Percent
Common Stock	19.7
Preferred Stock	18.6
Allocated Book Credits	26.6
Unallocated Reserves	10.6
Equity Certificates (without maturity date)	18.7
Equity Certificates (with maturity date)	4.9
Other Miscellaneous Equity	0.6
Membership Certificates	0.3
	100.

When farmer-members are not asked or are not willing to provide adequate capital, a cooperative is forced to borrow money to offset looses and to maintain working capital. The additional borrowing adds to the total cost of the operations and, if marketing conditions or operating procedures are not changed, losses will be magnified. The cooperative is then less and less able to operate profitably due to the higher interest costs.

II. Sources of Debt Capital
Where Can It Be Borrowed?

Sources of Borrowed Capital	Percent
Banks for Cooperatives	57.6
Individuals	19.3
Commercial Banks	9.6
Other Farmer Cooperatives	7.2
Other Sources	3.1
Sources not reported	3.2
	100.

I believe that cooperatives can achieve adequate financing in the future if they have a balance of the following financing methods.

1. A base capital plan - a permanent capital program in which, after total capital needs are determined, each member or patron contributes a net amount of equity capital in proportion to his use of the cooperative and receives no interest. This is to provide a degree of fairness in terms of investment.
2. A traditional revolving fund plan in which each year, at the discretion of the board, a portion of the oldest equity capital is returned to members.
3. A permanent capital fund in which interest is paid annually on equity capital, but date of redemption is at the discretion of the board of directors. Level of investment by individual members may vary considerably.

4. Borrowed capital from lending institutions, with the Bank for Cooperatives being the major lender.

5. Special purpose financing - such as industrial revenue bonds or lease financing.

6. For some of the larger cooperatives - leveraged leasing.

I don't pretend to know what a proper balance of these types of financing should be. I suspect that the proper balance would be somewhat different for each cooperative. As cooperatives get larger and capital needs increase, members may have to shift some of the risk to outside investors. The use of leverage can result in a favored postition for cooperative membership, but certainly for only as long as the cooperative is able to realize a greater return on its assets than it pays interest on debt.

In closing I would emphasize five major considerations which are very important for cooperatives in planning or adjusting their financial structure.

1. They must generate more permanent capital to replace or supplement traditional revolving types of capital.

2. They must assure that the member-user provides the major portion of equity capital.

3. They must maintain equitable membership participation in providing equity capital.

4. They should maximize, within strict limits, financial leverage.

5. They must maintain a sound financial structure.

6. Directors of cooperatives must take care in seeing that the organization does not outgrow the capabilities of its management.

III. Summary Questions

A. Should your coop use equity or debt capital to finance a new project? Answer depends on many factors, e.g., debt-equity position, exempt or non-exempt status.

B. Does your coop have provisions for paying back stock and certificate obligations? If you do not know, find out when you return.